

**IN THE INCOME TAX APPELLATE TRIBUNAL  
BANGALORE BENCH 'B', BANGALORE**

**BEFORE SHRI S.K.YADAV, JUDICIAL MEMBER  
AND  
SHRI A. K. GARODIA, ACCOUNTANT MEMBER**

**IT (TP) A No.1494(Bang) 2010  
(Assessment year : 2006-07)**

M/s Molex India Tooling Pvt. Ltd.,  
Plot No.6A, Sadarmanagala Industrial Area,  
Bangalore -560 067

**Pan No.AACCM6091N/MA-336**

Appellant

**Vs**

The Deputy Commissioner of Income Tax,  
Circle-12(1),  
Bangalore

Respondent

**Assessee by : Shri P.K Prasad, CA  
Revenue by : Ms. Neera Malhotra, CIT**

**Date of hearing : 03-08-2016  
Date of pronouncement: : 18-10-2016**

**ORDER**

**PER SHRI A.K.GARODIA, AM**

This is an assessee's appeal directed against the assessment order passed by the AO on 22-09-2010 u/s 143(3)r.w.s.144C(5)r.w.144C(8) of the IT Act, 1961 as per the directions of DRP.

2. The grounds raised by the assessee are as under;

*“With respect to the international transactions entered into by Molex India Tooling Private Limited (hereinafter referred to as the "Appellant"), a reference was made under the provisions of Section 92CA by the Assistant Commissioner of Income-tax, Circle - 12(1) post obtaining the approval of the Commissioner of Income-tax, Bangalore - III.*

*Transfer Pricing proceedings were taken up subsequent to the aforementioned reference and the learned Transfer Pricing Officer ("TPO") after taking into cognizance the various submissions made by the Appellant, made an adjustment of Rs.58,553,403 in respect of the international transactions entered into by the Appellant u/s 92CA of the Income Tax Act.*

*Aggrieved by such an adjustment to the Arm's Length Price (hereinafter referred to as "ALP") as originally determined by the Appellant, the appellant took recourse to the Dispute Resolution Panel ("DRP") as constituted under the Income-Tax Dispute (Resolution Panel) Rules, 2009. As provided under the said Rules, the appellant filed a comprehensive set of objections set out under various grounds against the order passed by the learned TPO. The Honourable DRP, subsequent to providing an opportunity for the appellant to represent the case before the Panel, passed an order dated 22<sup>nd</sup> September, 2010, upholding the contentions and consequently the adjustment to the ALP as made by the TPO.*

*Subsequently, an order was passed by the learned Assessing Officer (hereinafter referred to as "AO") dated 22nd October, 2010 (received on 28<sup>th</sup> of October 2010 by the Appellant), under sub section (3) of section 147 in pursuance of the directions of the Honourable DRP.*

### *I. Transfer Pricing*

*•The appellant wishes to state that the Honourable DRP and the learned AO grossly erred in upholding the income adjustment proposed by the learned TPO in arriving at the ALP of the international transactions entered into by the appellant. The appellant is in appeal before the honourable bench of the Income Tax Appellate Tribunal (hereinafter referred to as "ITA T") under section 253 (1) (d) against the order passed by the learned AO in pursuance of the directions of the Honourable DRP.*

#### *1. Adjustments for material differences*

*•The Honourable DRP and the learned AO have erred in accepting the contention of the TPO that the transactions are not at arm's length price.*

*•The Honourable DRP and the learned AO have erred in accepting the contention of the TPO, wherein the TPO has rejected the quantitative adjustments provided by the appellant for the differences in production capacity utilised by the appellant and the comparable companies.*

•The Honourable DRP and the learned AO have erred in accepting the contention of the TPO, wherein the TPO has provided adjustments only in respect of depreciation costs and no adjustments for the expenses which are fixed in nature for difference in the production capacity utilised by the appellant and the comparable company.

## 2. Gross Margin Analysis

•The Honourable DRP and the learned AO have erred in rejecting the gross margin analysis provided by the appellant.

## 3. Use of contemporaneous data

•The Honourable DRP and the learned AO erred in concluding that the appellant ought to have employed contemporaneous data in the preparation of the Transfer Pricing report. This argument of the Honourable DRP is not valid on the principle of fairness and natural justice, as the appellant cannot be expected to use data that is unavailable in the databases at the time of preparing the documentation.

•The Honourable DRP and the learned AO erred in interpreting the word "Shall" in Rule 10B (4) to mean that data for the same financial year in which the international transaction was actually entered into is a mandatory requirement. Also the appellant wishes to submit that the Honourable DRP and the learned AO ought to have appreciated that the transfer pricing regulations provide contemporaneous documentation to be mandatory, and not use of data for the same financial

year.

•*The Honourable DRP and the learned AO ought to have appreciated the fact that the objective underlying the use of multiple-year data was to ensure that the outcomes of the international transactions for the year under consideration were based on all the earlier periods which were relevant for determination of transfer price. Moreover the data of the preceding two financial years gives a clear indication of the business and economic conditions prevailing at the beginning of the relevant financial year i.e. the time when the transfer prices are set up, and the purpose of using multiple year data is to minimize and even out the impact of any abnormal factor which might have unduly influenced the outcomes of the data used for the comparability analysis.*

•**4. Safe harbour and application of  $\pm 5\%$  Arm's Length range**

•*The Hon'ble DRP and the ld. AO have erred in supporting the learned TPO's misinterpretation that the amended provision regarding the provision of the arm's length range as per the Finance Act, 2009 was applicable to the financial year (FY) 2005-06 as well.*

•*The Hon'ble DRP and the ld. AO ought to have considered the fact that the amendment was introduced with effect from 1<sup>st</sup> October 2009 and the said amendment was not retrospective in nature. Further, the amendment is substantive in nature and not merely procedural. It is an accepted legal*

*position that changes of a substantive nature cannot be construed to be retrospective, unless expressly provided by the statute. Therefore, the amendment to Sec.92C should not be interpreted to cover the assessment year 2006-07. This is further supported by the CBDT Circular No.05/2010 dated 3<sup>rd</sup> June 2010, which clarifies that the amended safe harbor provisions are applicable to assessments for the year ended 31 March 2009.*

*•Without prejudice to any of the appellant's other grounds of appeal, if at all any adjustment is made, the same should be made only to the lower limit of the 5% range set out u/s 92C(2).*

*•The appellant craves leave to add, alter and modify the above grounds during the course of the appeal.*

*•For the above and any other grounds which may be raised at the time hearing, it is prayed that the order of the learned AO be set aside.*

The ld. AR of the assessee submitted a copy of the synopsis containing all the arguments of the assessee before the Tribunal and the same is reproduced herein below:

### **SYNOPSIS**

#### *1. Background:*

*1.1. Molex India Tooling Private Limited ('MITPL' or 'Appellant') was engaged in manufacture of machine tools, tooling spares, housing, dies and moulds and commenced the commercial production on March 1, 2002.*

1.2. Due to underutilization of the production capacity, the Appellant suffered losses during the financial year (FY) 2005-06.

2. Proceedings before the learned Transfer Pricing Officer (,TPO,):

2.1. The Appellant, during the Transfer Price (TP) assessment, submitted that it was in a start-up phase and consequently, the production capacity was underutilized. Accordingly, the Appellant submitted Gross Margin analysis establishing the arm's length nature of the international transactions undertaken by the Appellant.

2.2. Further, the Appellant provided the computation of operating cost mark-up of the comparables post adjusting for the differences in the production capacity utilized by the Appellant and the comparable companies ('capacity utilization adjustment').

2.3. The learned TPO acknowledged the difference of underutilization of production capacity between the Appellant and the comparable companies, and considered the ratio of Profit before Depreciation, Interest and Taxes (PBDIT) to Total Operating Cost excluding depreciation (PBDIT / TC) as the Profit Level Indicator (PU). Hence, the learned TPO computed the Appellant's PLI to be (-) 31.46%.

2-4. The learned TPO arrived at a comparable PLI of 18.80% and provided an adjustment of INR 5,70,01,235/-.

2.5. In addition to the above, the learned TPO determined the arm's length price of the transaction of purchase price of raw materials, production supplies and spares. In this regard, the learned TPO computed the arm's length price for the aforementioned transaction as follows:

<i>Particulars</i>	<i>Amount</i> <i>(INR)</i>
<i>Purchase price of raw materials, production spares</i>	<i>37,29,591</i>
<i>Sales in proportion to above purchases [(100%-31.46%) of INR 37,29,591]</i>	<i>25,56,261</i>
<i>Arm's Length Margin on Sales (PBDIT / TC)</i>	<i>14.82</i>
<i>Arm's Length Price of the aforementioned [(100%-18.80%) of INR 25,56,261]</i>	<i>21,77,423</i>

Accordingly, the learned TPO provided adjustment of INR 15,52,168/-.

2.6. Therefore the total adjustment provided by the learned TPO was INR 5,85,53,403/-.

### *3. Proceedings before the learned Dispute Resolution Panel {'Panel'}*

3.1. The learned Panel upheld the action of the learned TPO and dismissed the objections of the Appellant.

### *4. Proceedings before the Honorable Income-tax Appellate Tribunal (,Tribunal')*

4.1. The Appellant would like to humbly submit before the Honorable Tribunal that the learned TPO erred in not providing the capacity utilization adjustment and changing the PLI from Operating Cost Mark-up to ratio of PBDIT / TC when depreciation is an essential component of the operations, it being related to the machinery used for the manufacturing activity. Also, the learned TPO erred in only considering the depreciation cost as fixed without considering the other fixed costs of the Appellant.

4.2. The Appellant also would humbly submit before the Honorable Tribunal that while computing the PLI of the Appellant, the transaction of purchase of raw materials, production supplies and spares was considered. The adjustment to the PLI of the Appellant was already provided. Therefore, adjusting the aforementioned transaction tantamounts to double adjustment.

4.3. Further, the Appellant wishes to humbly submit before the Honorable Tribunal that the annual reports of Guindy Machine Tools Limited and United Drilling Tools Limited were not available during the preparation of TP Study and accordingly, was not considered while computing the arm's length price. The Annual Reports of the aforementioned comparables are now available and hence, should be included in the list of comparables while determining the arm's length price. (Please refer to page no 4 & 10 of Appendix 3 of the TP Study and page no. of the 636 to 700 of the Annual Report Compendium submitted before the Honorable Tribunal).

*In addition to the above, the Appellant humbly submits that aforementioned comparables were also considered while the preparation of TP Study for the FY 2004-05 and the same were accepted by the learned TPO and learned Commissioner of Income-tax (Appeals) as comparables to the Appellant.*

4-4. The Appellant further submits that **Electronica Machine Tools Limited ("EMT")** is engaged in **trading activity in addition to the manufacture of machines and tungsten carbide products. Furthermore, EMT has amalgamated with Electronica Plastic Machines Pvt. Ltd., which is involved in manufacturing machines used to manufacture moulds, during year, thereby tantamounting to extraordinary activity.** Accordingly, making EMT **functionally not comparable** to the Appellant and consequently, ought to be rejected from the set of comparable companies (Please refer to page no. of the 465, 489 & 490 of the Annual Report Compendium submitted before the Honorable Tribunal).

4.5. Furthermore, the Appellant submits before the Honorable Tribunal that **Kulkarni Power Tools Limited ("KPT")** is engaged in activities of **manufacturing and trading of power tools and blowers. In addition to the aforementioned activities, KPT is also involved in distribution of electricity.** Further, the segment financial information is not available during the year. Accordingly, making KPT **functionally not comparable** to the Appellant and consequently, ought to be rejected from the set of comparable companies (Please refer to page no. of the 520, 529 & 530 of the Annual Report Compendium submitted before the Honorable Tribunal).

4.6. Furthermore, the Appellant submits that the operating cost mark-up of the Appellant and the comparable companies computed by the learned TPO was erroneous, consequently, the Appellant submits the correct computation before the Honorable Tribunal.

4.7. Furthermore, the learned TPO / learned DRP did not provide the adjustment with respect to the differences in the working capital between the comparable companies and the Appellant. Accordingly, the Appellant humbly submits before the Honorable Tribunal that an adjustment to the operating profit to operating cost of comparables ought to be provided towards the difference in working capital levels of the comparable companies and the Appellant.

4.8. The Appellant relies on the ruling of *24/7 Customer Con Pt. Ltd.* [ITA.227/Bang/20101 wherein the Honorable Tribunal has accepted the additional ground filed by the Appellant seeking economic adjustment and where such claim was not placed earlier during transfer pricing assessment or appellate proceedings.

4.9. The Appellant humbly submits that the capacity utilization adjustment is to be provided on the fixed costs of the comparable companies. Similar directions have been provided by various Tribunal in the case of *Claus India Pvt. Ltd.* [ITA No. 1783/ DEL / 20111 and *Petro Araldite Pvt. Ltd.* [ITA No. 3782/ MUM / 2011].

4.10. Further, the Appellant humbly submits that the capacity utilized by the Appellant and the comparable companies computed earlier were erroneous. Accordingly, the Appellant has computed the correct capacity utilized as per the ruling of *Panasonic AVC Networks India Pvt. Ltd.* [ITA No. 4620/ DEL / 20111.

4.11. Following the above mentioned rulings and contentions, the Appellant has computed the average operating cost mark-up of the comparable companies considering the capacity utilization adjustment at (-) **88.24%**.

4.12. The operating cost mark-up of the Appellant has been correctly computed at (-) **46.03%** which is higher than the adjusted average operating cost mark-up of the comparable companies and therefore, is at arm's length.

4.13. Further, the Appellant wishes to humbly highlight before the Honorable Tribunal that during the course of TP Assessment for the AY 2007-08 of the Appellant, the learned TPO has considered the underutilization of capacity and held that the transfer price of the international transactions undertaken by the Appellant to be at arm's length".

We have considered the rival submissions. We find that apart from the request of the assessee for inclusion of two comparables and exclusion of two comparables, the main grievance of the assessee is regarding non-granting of adjustment on account of lower capacity utilization and working capital adjustment. In this regard reliance has been placed by the ld. AR of the assessee on various judicial pronouncements noted in the synopsis reproduced above. For exclusion of Electronica Machine tools Ltd., and Kulkarni Power Tools Ltd., assessee pointed out the annual reports of these two companies on the issue regarding these two companies raised by way of filing additional grounds. Regarding inclusion of two companies i.e M/s Guindy Machine Tools Ltd., and M/s United Drilling Tools Ltd., It has been submitted before us that these companies were rejected because unavailability of data, but since the data of these two companies are now available in the annual report of these two companies, these two companies should be considered as good comparables. In view of these facts, we are of the considered opinion that the issue regarding inclusion of these two companies should go back to the file of the TPO/ AO for fresh decision. We order accordingly.

Regarding the adjustment on account of lower capacity utilization and working capital adjustment, we find that it is noted by the DRP in para-3.2 on page-3 of its order that the TPO highlighted the major cost

shown in the P&L account was the depreciation which in the case of tax payer was about 20% of the total cost against an average of 3.5% in the case of comparables. Thereafter, it is noted by the DRP that neutralize this difference the TPO has considered PBDIT as PLI by following the Tribunal order in the case of Sechefenacker Motherson Ltd., Vs ITO(2009-TIOL-376-ITAT-Delhi. It is further noted by the DRP in the same para with regard to the claim of assessee for other costs such as employee cost, repair and maintenance cost, office supplies, filing fee etc., It has been observed by the TPO that these cases are slightly higher than the comparables in the ratio of about 7 to 6 but just because the costs were higher, adjustment could not be considered. In the light of these facts, now we consider the applicability of various judgments cited by the Id. AR of the assessee on this issue.

First judgment cited is the Tribunal order rendered in the case of CIT Vs Class India Pvt.Ltd., in ITA No.1783/Del/2011 dated 12-08-2015. Copy available on pages 701 -726 of the paper book, para no.9.3 to 10.2 of this Tribunal order available on pages 714 to 720 of the paper book are relevant for the present issue in dispute hence, these paras are reproduced herein below for the sake of ready reference;

*“9.3. Sub-rule (2) of Rule 10B provides that the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to certain factors which have been enumerated therein. Rule 10B(3) states that an uncontrolled transaction*

*shall be comparable to an international transaction, if either there are no differences between the two or a 'reasonably accurate adjustment can be made to eliminate the material effects of such differences'. When we read sub-clauses(ii) & (iii) of Rule 10B(1)(e) in juxtaposition to sub-rules (2) & (3) of rule 10B, the position which emerges is that the net operating profit margin of comparable companies calls for adjustment in such a manner so as to bring both the international transaction and comparable cases at the same pedestal. In other words, if there are no differences in these two, then the average of the net operating profit margin of the comparable companies becomes a benchmark. However, in case there are some differences between the comparables and the assessee, then the effect of such differences should be ironed out by making suitable adjustment to the operating profit margin of comparables. That is the way for bringing both the transactions, namely, the international transaction and the comparable uncontrolled transactions, on the same platform for making a meaningful and effective comparison. The above analysis overtly transpires that the law provides for adjusting the profit margin of comparables on account of the material differences between the international transaction of the assessee and comparable uncontrolled transactions. It is not the other way around to adjust the profit margin of the assessee. In other words, the net operating profit margin realized by the assessee from its international transaction is to be computed as such, without adjusting it on account of differences with the comparable*

*uncontrolled transactions. The adjustment, if any, is required to be made only in the profit margins of the comparables.*

*9.4. Reverting to the facts of the instant case, we find that the authorities below have adjusted the operating costs of the assessee in allowing the capacity adjustment. As against that, the correct course of action provided under the law is to adjust the operating costs of the comparable and their resultant operating profit. There is hardly need to accentuate that there can be no estoppel against the law. Once the law enjoins for doing a particular thing in a particular manner alone, it is not open to anyone to adopt a contrary or different approach. As the authorities below have adopted a course of action in allowing adjustment, which is not in consonance with law, we cannot approve the same. The impugned order is set aside and the matter is restored to the file of the TPO/AO for giving effect to the amount of idle capacity adjustment in the operating profit of the comparables and not the assessee.*

***ii. How to compute capacity utilization adjustment under TNMM :-***

*10.1. Under the TNMM, the ALP of an international transaction is determined by computing and comparing the percentage of operating profit margin realized by the assessee with that of the comparables. We have noticed*

*above that the difference in the capacity utilizations is an important factor, which needs to be adjusted. No mechanism has been given under the Act or the rules for computing the amount of capacity utilization adjustment.*

*10.2. On an overall understanding, we feel that under the TNMM, the first step in granting capacity utilization adjustment is to ascertain the percentage of capacity utilization by the assessee and comparables. There can be no difficulty in working out these percentages. The second step is to give effect (positive or negative) to the difference in the percentage of capacity utilizations of the assessee vis-à-vis comparables, one by one, in the operating profit of comparables by adjusting their respective operating costs. Operating costs can be either fixed or variable or semi-variable. One needs to split semi-variable costs into the fixed part and variable part. In so far as the variable costs and the variable part of the semi-variable costs are concerned, these remain unaffected due to any under or over utilization of capacity. Accordingly, such variable operating costs remain unchanged. The adjustment is called for only in respect of the fixed operating costs and fixed part of semi-variable costs. Such costs are scaled up or down by considering the percentage of capacity utilization by the assessee and such comparable. It can be illustrated with the help of a simple example. Suppose the fixed costs incurred by a comparable (say, A) are Rs. 100 and it has capacity utilization of 50% as against the capacity utilization of 25% by the assessee. The above percentages show*

*that the assessee has incurred full fixed costs with 25% of the utilization of its capacity, as against A incurring full fixed costs with 50% of its capacity utilization. This divulges that the assessee has incurred relatively more fixed costs and A has incurred lower costs. In order to make an effective comparison, there arises a need to obliterate the effect of this difference in capacity utilizations. It can be done by proportionately scaling up the fixed costs incurred by A so as to make it fully comparable with the assessee. This we can do by increasing the fixed costs of A to Rs. 200 (Rs.100 into 50/25) as against the actually incurred fixed costs by it at Rs.100. When we compute operating profit of A by substituting the fixed costs at Rs.200 with the actually incurred at Rs.100, it would mean that the fixed costs incurred by the assessee and A are at the same capacity utilization. There can be converse situation as well. Suppose the fixed costs incurred by a comparable (say, B) are Rs. 100 and it has capacity utilization of 25% as against the capacity utilization of 50% by the assessee. The above percentages show that the assessee has incurred full fixed costs at 50% of the utilization of its capacity, as against B incurring full fixed costs at 25% of the capacity utilization. This deciphers that the assessee has incurred relatively lower fixed costs and B has incurred higher costs. This difference in capacity utilizations can be eliminated by proportionately scaling down the fixed costs incurred by B so as to make it fully comparable. This we can do by reducing the fixed costs of B to Rs. 50 (Rs.100 into 25/50) as*

*against the actually incurred fixed cost by it at Rs.100. When we compute operating profit of B by substituting the fixed costs at Rs.50 with the actually incurred at Rs.100, it would mean that the fixed costs incurred by the assessee and B are at the same capacity utilization level.*

From the above paras of the Tribunal order, it is seen that the Tribunal has given a detailed guidelines as to how to make or grant capacity utilization adjustment. Hence, we feel it proper that this matter also should go back to the file of the AO/TPO for granting capacity utilization adjustment as per the guidelines given by the Tribunal in the case of DCIT Vs Class India Pvt.Ltd., (Supra). It is ordered accordingly.

In the result, the appeal stands allowed for statistical purposes in the terms indicated above.

Order pronounced in the open court on the date mentioned on the caption page.

**(SUNIL KUMAR YADAV)**  
**JUDICIAL MEMBER**

Place: Bangalore:  
D a t e d : 18.10.2016

**am\***

**Copy to :**

- 1 Appellant
- 2 Respondent
- 3 CIT(A)-II Bangalore
- 4 CIT
- 5 DR, ITAT, Bangalore.
- 6 Guard file

**(A.K. GARODIA)**  
**ACCOUNTANT MEMBER**

By order, AR, ITAT, Bangalore

1. श्रुतलेख की तारीख.....  
DATE OF DICTATION.....
2. तारीख, जिस पर टाइप किया हुआ मसौदे, संबंधित सदस्य के सामने रखा गया है  
DATE ON WHICH TYPED DRAFT IS PLACED BEFORE THE DICTATING MEMBER.....
3. तारीख जिस पर अनुमोदित मसौदे व. निजी सचिव/निजी सचिव के पास वापस आए  
DATE ON WHICH THE APPROVED DRAFT COMES TO THE PS/Sr.PS.....
4. घोषणा के लिए आदेश संबंधित सदस्य के सामने रखने की तिथि  
DATE ON WHICH THE ORDER IS PLACED BEFORE THE DICTATING MEMBER FOR PRONOUNCEMENT.....
5. आदेश नि.सचिव/व.नि.सचिव के पास वापस आने की तिथि  
DATE ON WHICH THE ORDER COMES BACK TO THE PS/Sr.PS.....
6. आदेश अपलोड करने की तिथि  
DATE OF UPLOADING THE ORDER ON WEBSITE.....
7. अगर अपलोड नहीं किया तो, उसका कारण  
IF NOT UPLOADED, FURNISH THE REASON FOR DOING SO.....
8. बेंच लिपिक के पास फाइल जाने की तिथि  
DATE ON WHICH THE FILE GOES TO THE BENCH CLERK.....
9. आदेश ज़ेरोक्स/पृष्ठांकन के लिए भेजने की तिथि  
DATE ON WHICH ORDER GOES FOR XEROX & ENDORSEMENT.....
10. फाइल मुख्य लिपिक के पास जाने की तिथि  
DATE ON WHICH THE FILE GOES TO THE HEAD CLERK.....
11. आदेश पर हस्ताक्षर के लिए फाइल सहायक रजिस्ट्रार के पास जाने की तिथि  
THE DATE ON WHICH THE FILE GOES TO THE ASSISTANT REGISTRAR FOR SIGNATURE ON THE ORDER.....
12. अधिकरण आदेश के प्रेषण के लिए फाइल प्रेषण विभाग में जाने की तिथि  
THE DATE ON WHICH THE FILE GOES TO DESPATCH SECTION FOR DESPATCH OF THE TRIBUNAL ORDER.....
13. आदेश की प्रेषण की तिथि  
DATE OF DESPATCH OF ORDER.....